CURTIS BANKS

CASE STUDY

ENHANCED PROTECTION AND PCLS

APPROVED FOR ADVISER USE ONLY | APRIL 2023

Individuals who had enhanced protection without protected tax free cash used to have normal tax free cash entitlement: in other words, 25% of the standard lifetime allowance. That was the case until the standard lifetime allowance dropped below its original value of £1.5m on 6 April 2014. At that point, the rules changed to make sure that such individuals' tax free cash entitlement was still based on a lifetime allowance of £1.5m, so their entitlement was no lower than it was at A-Day (6 April 2006). However, there is still a quirk in the rules which clients need to consider.

The Challenges

At A-Day (6 April 2006) Luke's pension funds were worth almost £1.5m. He was no longer contributing to his pensions but did not plan to take benefits in the near future and was optimistic about the potential for growth. He decided to apply for enhanced protection, understanding that this would mean he did not have to worry about the lifetime allowance which was being introduced with the new rules. His enhanced protection was issued without tax free cash protection, as his lump sum rights at the time were less than £375,000 – the standard tax free cash entitlement under the new rules.

Following the introduction of the pension freedoms in 2015, Luke began to think about accessing his pension benefits. He remembered reading that the total tax free amount he could receive would be up to £375,000 (i.e. 25% of £1.5m) rather than 25% of the new, lower lifetime allowance. Luke began to access his pension using uncrystallised funds pension lump sums (UFPLS). He took the following payments:

June 2015 - £500,000
August 2016 - £200,000
July 2017 - £300,000

25% of each payment was tax free and the remainder was subject to income tax.

In July 2021, Luke decides to take another UFPLS. By his calculations, he has received £250,000 of his tax free allowance and should have £125,000 remaining. Therefore he decides to take a UFPLS of £500,000. He emails Curtis Banks, his scheme administrator, to ask them to arrange disinvestments in order to make the payment. Petra receives Luke's email and immediately spots a problem. She calls Luke to discuss his request.

The Actions

Petra confirms that Luke does not have enough lifetime allowance remaining to take a £500,000 UFPLS. Luke thinks that Petra must have made a mistake and confirms that he has enhanced protection. Petra goes on to explain that while Luke's enhanced protection means that he will never have to pay a lifetime allowance charge, strictly speaking he is still subject to the lifetime allowance and its associated rules. With the UFPLS payments he has taken so far, he has used up 90% of his lifetime allowance. He only has 10% remaining, which in the 2021/22 tax year equates to £107,310.

Luke still doesn't understand what the problem is if he can't incur a lifetime allowance charge. Petra explains that the problem is with the UFPLS rules, which state that for individuals who are under age 75, a UFPLS payment must be fully within the person's remaining lifetime allowance.

Therefore the maximum UFPLS which Luke can withdraw is £107,310, with a tax free element of £26,827.50. After that, Luke would need to explore other options for accessing his pension benefits, such as drawdown or purchasing an annuity.

Luke says that he will probably take the £107,310 UFPLS now, and then have a further think about his other withdrawal options. Petra confirms that this will be possible, but adds that while she can't offer Luke advice about what he should do, there is another issue she needs to make him aware of. If Luke takes a £107,310 UFPLS, he will lose the remaining tax free cash entitlement. This is because of a rule which states that a person is only eligible to receive tax free cash if they have at least some lifetime allowance remaining.

Petra explains that this rule usually makes sense, as someone's tax free cash entitlement is normally directly linked to their lifetime allowance entitlement: most people will run out of entitlement to both at the same time. However, in Luke's case his lifetime allowance entitlement (whilst irrelevant from an excess charges perspective) will run out before his tax free cash entitlement. This means that in order to receive the maximum tax free cash available, Luke must make sure that the crystallisation which uses up or exceeds his lifetime allowance is also used to pay his total remaining tax free cash entitlement. As it isn't possible to do this using UFPLS because of the rule restricting the overall value of the UFPLS payment, Luke would need to consider another form of pension benefits. Petra reiterates that she cannot offer Luke advice, and recommends that he speaks to an adviser before making his final decision. She offers to send Luke a summary of their conversation in writing so he has it to refer to later.

The Results

After speaking to an adviser, Luke decides that he will use flexi-access drawdown to access his remaining tax free cash. He can crystallise £500,000 and take £125,000 as tax free cash, and the remaining £375,000 will go into drawdown. He can then withdraw this straight away as income and achieve a similar outcome to taking a UFPLS, or opt to leave some or all of it invested within his pension until needed. As UFPLS will no longer be available, Luke also understands that drawdown will most likely be his chosen option for withdrawing his remaining uncrystallised benefits in the future.

Important points to consider

The value of pension funds may fall as well as rise. Your money is tied up until you take your benefits. Benefits can generally be taken any time after age 55, although this is due to increase to 57 in 2028.

This information is based on our understanding of current legislation, including (but not limited to) FCA, PRA and HMRC regulation. It does not constitute any form of advice.

Contact details

If you'd like to speak to us about anything in this case study, please contact us on:

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We may record and monitor calls. Call charges will vary.

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Please remember not to send any personal, financial or banking information via email as it is not a secure method of communication.